



JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

CONSOLIDATED FINANCIAL STATEMENTS

AND

REQUIRED SUPPLEMENTARY INFORMATION

DECEMBER 31, 2013 AND 2012

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL
AND AFFILIATED ORGANIZATIONS**

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Jackson County Schneck Memorial Hospital
and Affiliated Organizations
Seymour, Indiana

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Jackson County Schneck Memorial Hospital (d/b/a Schneck Medical Center) and Affiliated Organizations (collectively the "Medical Center"), component units of Jackson County, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of operations and changes in net position, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the Guidelines for Audits of County and City Hospitals by Independent Certified Public Accountants, issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Medical Center as of December 31, 2013 and 2012, and the results of its operations, its changes in net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Changes in Accounting Principles

As discussed in Note 2 to the consolidated financial statements, in 2013, the Medical Center adopted new accounting guidance, Governmental Accounting Standards Board (GASB) Statement No. 61, *The Financial Reporting Entity: Omnibus an amendment of GASB Statements No. 14 and No. 34*, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

Report on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Blue & Co., LLC

Louisville, KY
April 28, 2014

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2013 AND 2012

Management's discussion and analysis of the financial performance of Jackson County Schneck Memorial Hospital (d/b/a Schneck Medical Center) (the "Hospital") and Affiliated Organizations (collectively the "Medical Center") provides an overview of the Medical Center's financial activities and performance for the years ended December 31, 2013 and 2012. This discussion and analysis should be read in conjunction with the accompanying Medical Center's consolidated financial statements.

FINANCIAL HIGHLIGHTS

The Medical Center's net position increased \$22,488,303 from 2012 to 2013 and included income from operations of \$15,772,990. During 2013, the Medical Center's total operating revenue increased by 52.5% to \$195,587,263 with total operating expenses increasing by 57.1% to \$179,814,273.

- The Medical Center raised rates by 1% in 2013.
- During 2013, the Medical Center assumed ownership of the bed licenses of nine additional long term care facilities. The Medical Center entered into management agreements with the previous owners and/or management entities to manage the day-to-day operations of the facilities. The Medical Center also leases the buildings and premises from the prior owners. The ownership transactions occurred throughout the year with one facility license acquired March 1, 2013, one with an effective date of April 1, 2013, three effective May 1, 2013 and four effective August 1, 2013. The operations of the facilities occurring subsequent to the ownership effective dates are included in the financial results of the Medical Center. The amount included in income from operations attributable to the nursing facilities was \$7,196,767 in 2013.
- In 2012 and 2013, the Medical Center qualified for electronic health record meaningful use payments from both Medicare and Medicaid. The amount recorded in income from operations is \$1,390,674 in 2013 and \$1,846,587 in 2012.
- In an effort to increase Medicaid reimbursement to hospitals, the State of Indiana implemented a Hospital Assessment Fee program in 2012. Indiana hospitals are assessed a fee which allows the state to access Federal funds allowing it to pay Medicaid patient claims at higher rates, not to exceed Medicare reimbursement. The Medical Center incurred \$4,731,229 in Hospital Assessment Fees expense in 2013.

The Medical Center's net position increased \$16,910,638 from 2011 to 2012 and included income from operations of \$13,778,086. During 2012, the Medical Center's total operating revenue increased by 16.5% to \$128,242,340 with total operating expenses increasing by 18.8% to \$114,464,254.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2013 AND 2012

- The Medical Center did not raise charge rates during 2012.
- During 2012, the Medical Center assumed ownership of the bed licenses of two long term care facilities. The Medical Center entered into management agreements with the previous owners to manage the day-to-day operations of the facilities. The Medical Center also leases the buildings and premises from the prior owners. The ownership transactions occurred effective July 1, 2012 and October 1, 2012, respectively. The operations of both facilities occurring subsequent to the ownership effective dates are included in the financial results of the Medical Center. The amount included in income from operations attributable to the two facilities was \$485,796 in 2012.
- In 2012, the Medical Center qualified for electronic health record meaningful use payments from both Medicare and Medicaid. The amount recorded in income from operations is \$1,846,587.
- The Medical Center incurred \$5,816,239 in Hospital Assessment Fees expense in 2012.

FINANCIAL STATEMENTS

The consolidated financial statements of the Medical Center present information about the Medical Center using financial reporting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information. The consolidated balance sheets include all of the Medical Center's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to the Medical Center's creditors (liabilities). It also provides the basis for compiling rate of return, evaluating the capital structure of the Medical Center and assessing the liquidity and financial flexibility of the Medical Center. All of the current and prior year's revenues and expenses are accounted for in the consolidated statements of operations and changes in net position. This statement measures the financial results of the Medical Center's operations and presents revenues earned and expenses incurred. The consolidated statements of cash flows provide information about the Medical Center's cash flows from operating activities, capital and related financing activities, and investing activities, plus provide information on the sources and uses of cash during both the current and prior year.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2013 AND 2012

FINANCIAL ANALYSIS

The consolidated balance sheets and the consolidated statements of operations and changes in net position report information about the Medical Center's activities. These two statements report the net position of the Medical Center and its changes. Increases or decreases in the Medical Center's net position are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic conditions, population changes (including uninsured and medically indigent individuals and families) and new or changed governmental legislation should also be considered.

CONDENSED FINANCIAL INFORMATION

A summary of the Medical Center's consolidated balance sheets as of December 31, 2013 and 2012 is presented below:

	2013	2012	\$ Change	% Change
Assets				
Cash and investments	\$ 161,903,070	\$ 151,517,262	\$ 10,385,808	6.9%
Capital assets	79,616,180	78,885,608	730,572	0.9%
Other assets	49,701,698	31,728,555	17,973,143	56.6%
Deferred outflows	1,984,591	851,704	1,132,887	133.0%
Total assets and deferred outflows	<u>\$ 293,205,539</u>	<u>\$ 262,983,129</u>	<u>\$ 30,222,410</u>	11.5%
Liabilities				
Long-term debt, including current portion	\$ 37,709,527	\$ 50,106,555	\$ (12,397,028)	-24.7%
Other current and noncurrent liabilities	48,326,140	28,195,005	20,131,135	71.4%
Total liabilities	86,035,667	78,301,560	7,734,107	9.9%
Net position				
Investment in capital assets net of related debt	43,891,244	29,630,757	14,260,487	48.1%
Restricted expendable net position	5,158,193	6,048,422	(890,229)	-14.7%
Restricted nonexpendable net position	336,528	306,945	29,583	9.6%
Unrestricted	157,783,907	148,695,445	9,088,462	6.1%
Total net position	<u>207,169,872</u>	<u>184,681,569</u>	<u>22,488,303</u>	12.2%
Total liabilities and net position	<u>\$ 293,205,539</u>	<u>\$ 262,983,129</u>	<u>\$ 30,222,410</u>	11.5%

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2013 AND 2012

A summary of the Medical Center's consolidated balance sheets as of December 31, 2012 and 2011 is presented below:

	2012	2011	\$ Change	% Change
Assets				
Cash and investments	\$ 151,517,262	\$ 133,406,829	\$ 18,110,433	13.6%
Capital assets	78,885,608	82,259,968	(3,374,360)	-4.1%
Other assets	31,728,555	25,986,379	5,742,176	22.1%
Deferred outflows	851,704	945,040	(93,336)	-9.9%
Total assets and deferred outflows	<u>\$ 262,983,129</u>	<u>\$ 242,598,216</u>	<u>\$ 20,384,913</u>	8.4%
Liabilities				
Long-term debt, including current portion	\$ 50,106,555	\$ 51,790,206	\$ (1,683,651)	-3.3%
Other current and noncurrent liabilities	28,195,005	23,037,079	5,157,926	22.4%
Total liabilities	78,301,560	74,827,285	3,474,275	4.6%
Net position				
Investment in capital assets net of related debt	29,630,757	32,359,842	(2,729,085)	-8.4%
Restricted expendable net position	6,048,422	5,888,963	159,459	2.7%
Restricted nonexpendable net position	306,945	285,671	21,274	7.4%
Unrestricted	148,695,445	129,236,455	19,458,990	15.1%
Total net position	<u>184,681,569</u>	<u>167,770,931</u>	<u>16,910,638</u>	10.1%
Total liabilities and net position	<u>\$ 262,983,129</u>	<u>\$ 242,598,216</u>	<u>\$ 20,384,913</u>	8.4%

CONDENSED FINANCIAL INFORMATION

A summary of the Medical Center's consolidated statements of operations and changes in net position for the years ended December 31, 2013 and 2012 is presented below:

	2013	2012	\$ Change	% Change
Operating revenues				
Net patient service revenue	\$ 192,202,363	\$ 125,133,074	\$ 67,069,289	53.6%
Other revenue	3,384,900	3,109,266	275,634	8.9%
Total operating revenues	195,587,263	128,242,340	67,344,923	52.5%
Operating expenses				
Salaries and benefits	96,809,935	61,851,396	34,958,539	56.5%
Supplies and drugs	25,942,493	20,208,669	5,733,824	28.4%
Depreciation and amortization	8,868,277	8,740,769	127,508	1.5%
Other operating expenses	48,193,568	23,663,420	24,530,148	103.7%
Total operating expenses	<u>179,814,273</u>	<u>114,464,254</u>	<u>65,350,019</u>	57.1%
Income from operations	15,772,990	13,778,086	1,994,904	14.5%
Nonoperating revenues (expenses)	6,715,313	3,132,552	3,582,761	-114.4%
Change in net position	<u>\$ 22,488,303</u>	<u>\$ 16,910,638</u>	<u>\$ 5,577,665</u>	33.0%
Net position, end of year	<u>\$ 207,169,872</u>	<u>\$ 184,681,569</u>	<u>\$ 22,488,303</u>	12.2%

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2013 AND 2012

A summary of the Medical Center's consolidated statements of operations and changes in net position for the years ended December 31, 2012 and 2011 is presented below:

	2012	2011	\$ Change	% Change
Operating revenues				
Net patient service revenue	\$ 125,133,074	\$ 107,996,157	\$ 17,136,917	15.9%
Other revenue	<u>3,109,266</u>	<u>2,120,601</u>	<u>988,665</u>	46.6%
Total operating revenues	128,242,340	110,116,758	18,125,582	16.5%
Operating expenses				
Salaries and benefits	61,851,396	54,587,829	7,263,567	13.3%
Supplies and drugs	20,208,669	18,464,382	1,744,287	9.4%
Depreciation and amortization	8,740,769	8,770,138	(29,369)	-0.3%
Other operating expenses	<u>23,663,420</u>	<u>14,607,342</u>	<u>9,056,078</u>	62.0%
Total operating expenses	<u>114,464,254</u>	<u>96,429,691</u>	<u>18,034,563</u>	18.7%
Income from operations	13,778,086	13,687,067	91,019	0.7%
Nonoperating revenues (expenses)	<u>3,132,552</u>	<u>(2,063,171)</u>	<u>5,195,723</u>	251.8%
Change in net position	<u>\$ 16,910,638</u>	<u>\$ 11,623,896</u>	<u>\$ 5,286,742</u>	45.5%
Net position, end of year	<u>\$ 184,681,569</u>	<u>\$ 167,770,931</u>	<u>\$ 16,910,638</u>	10.1%

SOURCES OF REVENUE

The Medical Center derives the majority of its revenue from charges for patient care and related services. The Medical Center is reimbursed for services from a variety of sources including the Medicare and Medicaid programs, insurance carriers, managed care plans, and patients. The Medical Center has established payment arrangements with Medicare, Medicaid, and various commercial insurance carriers. Services provided under those arrangements are paid at predetermined rates and/or reimbursable cost as defined. Provisions have been made in the consolidated financial statements for contractual adjustments representing the difference between the standard charges for services and the actual or estimated payment.

The Medical Center's percentages of gross revenue by payor for 2013, 2012, and 2011 are as follows:

Payor Mix	2013	2012	2011
Medicare	39 %	39 %	38 %
Medicaid	21	13	12
Blue Cross	17	21	23
SIHO*	7	9	9
Other third-party payors	8	11	11
Self-pay	<u>8</u>	<u>7</u>	<u>7</u>
Total	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

*Southeastern Indiana Health Organization

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2013 AND 2012

OPERATING AND FINANCIAL PERFORMANCE

The Medical Center's financial performance from operations improved in 2013 in comparison to 2012 and the Medical Center's overall financial performance improved from 2012 to 2013. A discussion of the highlights of 2013 operations and changes in activity is presented below:

Revenues

The Medical Center's net patient service revenues increased by \$67,069,289 in 2013. This is primarily due to increased Medicaid reimbursement resulting from the State of Indiana's Hospital Assessment Fee Program, additional revenue relating to ownership of the eleven nursing home licenses, and increases in laboratory volumes, emergency department visits, surgeries, and births as compared to the prior year. Highlights of revenue activity are as follows:

- Patient volume increases were noted for births and surgeries, as well as emergency department visits, laboratory tests, and hospice patients. Patient volume decreases were noted in inpatient days and admissions, respiratory therapy, physical therapy, and home health services.

Expenses

Total operating expenses increased by \$65,350,019 in 2013. Highlights of this change are as follows:

- Salary and benefits costs increased \$34,958,539. This was due to staffing needs and wage costs due to the addition of new physician services including neurology and endocrinology and labor costs relating to the eleven long term care facilities.
- Purchased services increased \$12,155,647 due to legal fees involved in the acquisition of nine nursing home licenses, consulting fees relating to the formation of a clinical integration network, and an increase in maintenance contract fees.

The Medical Center's financial performance from operations improved slightly in 2012 in comparison to 2011 and the Medical Center's overall financial performance improved from 2011 to 2012. A discussion of the highlights of 2012 operations and changes in activity is presented below:

Revenues

The Medical Center's net patient service revenues increased by \$17,136,917 in 2012. This is primarily due to increased Medicaid reimbursement resulting from the State of Indiana's Hospital Assessment Fee Program, as well as a result of increases in laboratory volumes, emergency department visits, inpatient admissions, and births as compared to the prior year. Highlights of revenue activity are as follows:

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2013 AND 2012

- Patient volume increases were noted for inpatient admissions, births, and surgeries, as well as emergency department visits, laboratory tests, radiology procedures, occupational therapy, home-health care, and speech therapy. Patient volume decreases were noted in respiratory therapy, physical therapy, and hospice services.

Expenses

Total operating expenses increased by \$18,034,563 in 2012. Highlights of this change are as follows:

- As mentioned above, the State of Indiana implemented a Hospital Assessment Fee program in 2012. Indiana hospitals are assessed a fee which allows the state to access Federal funds allowing it to pay Medicaid patient claims at higher rates not to exceed Medicare reimbursement. The Hospital incurred \$5,816,239 in Hospital Assessment Fees in 2012.
- Salary and benefits costs increased \$7,263,567. This was due to staffing needs generated by increased patient volumes as well as labor costs relating to the two long term care facilities.
- Supply and drug costs increased \$1,744,287 due to an increase in patient volumes.

FINANCIAL ANALYSIS – CASH FLOWS

The Medical Center's 2013 cash flows increased \$4,403,795 due primarily to positive cash inflows received for patient services and investment income, which exceeded cash outflows for cash paid to employees and vendors and purchases of capital assets.

The Medical Center's 2012 cash flows increased \$13,460,644 due primarily to positive cash inflows received for patient services and investment income, which exceeded cash outflows for cash paid to employees and vendors and purchases of capital assets.

Capital Assets

	2013	2012	\$Change	%Change
Land and land improvements	\$ 10,733,539	\$ 10,428,911	\$ 304,628	2.9%
Leasehold improvements	672,661	672,661	-0-	0.0%
Buildings	83,234,449	80,146,074	3,088,375	3.9%
Equipment	55,408,178	52,030,961	3,377,217	6.5%
Construction in progress	2,265,565	1,054,500	1,211,065	114.8%
	152,314,392	144,333,107	7,981,285	5.5%
Less accumulated depreciation	72,698,212	65,447,499	7,250,713	11.1%
Capital assets, net	<u>\$ 79,616,180</u>	<u>\$ 78,885,608</u>	<u>\$ 730,572</u>	0.9%

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2013 AND 2012

Capital assets increased in 2013. During 2013, the Medical Center completed renovation of existing shell hospital space at a cost of \$2,107,018. In 2013, new generators were purchased in the amount of \$1,036,862. The Medical Center completed a renovation of its cystology surgical suite at a cost of \$474,767 and purchased new sterilization equipment costing \$481,326.

	2012	2011	\$Change	%Change
Land and land improvements	\$ 10,428,911	\$ 10,314,381	\$ 114,530	1.1%
Leasehold improvements	672,661	930,537	(257,876)	-27.7%
Buildings	80,146,074	77,786,900	2,359,174	3.0%
Equipment	52,030,961	48,696,613	3,334,348	6.8%
Construction in progress	1,054,500	2,332,925	(1,278,425)	-54.8%
	144,333,107	140,061,356	4,271,751	3.0%
Less accumulated depreciation	65,447,499	57,801,388	7,646,111	13.2%
Capital assets, net	<u>\$ 78,885,608</u>	<u>\$ 82,259,968</u>	<u>\$ (3,374,360)</u>	-4.1%

During 2012, the Medical Center purchased upgrades and additions to information technology software and equipment at a cost of \$1,022,752. The Medical Center also purchased a new telemetry system at a cost of \$403,645 as well as upgraded inpatient beds at a cost of \$326,045.

Long-Term Debt

At December 31, 2013, the Medical Center had long-term debt (including current portion) of \$37,709,527. This is comprised of \$37,244,088 in revenue bonds outstanding, and \$465,439 in notes payable.

At December 31, 2012, the Medical Center had long-term debt (including current portion) of \$50,106,555. This is comprised of \$49,323,821 in revenue bonds outstanding, and \$782,734 in notes payable.

ECONOMIC FACTORS AND 2014 BUDGET

The Medical Center's Board and management considered many factors when establishing the 2014 budget. Included was the status of the economy, which takes into consideration market factors and other environmental factors such as the following items:

- Advances in medical equipment and information systems technology and the need to replace obsolete equipment
- Decreasing reimbursement from governmental and commercial insurance payors
- Increasing number of uninsured, underinsured and/or indigent patients
- Increasing costs of medical supplies and pharmaceuticals
- Nationwide workforce shortages in nursing and other healthcare specialist positions

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2013 AND 2012

- Increasing awareness and expectations from the public on the quality of services
- Increased competition from niche providers
- Size, composition, and needs of the Medical Center's physician medical staff

CONTACTING THE MEDICAL CENTER

This report is designed to provide our citizens, customers and creditors with a general overview of the Medical Center's finances. These consolidated financial statements include the activities of the Hospital, Jackson County Schneck Memorial Hospital Foundation (the "Foundation"), Jackson Medical Building, LLC, and Health Development Corporation and Affiliated Organization ("HDC"). Separately-issued audited financial statements are available for both HDC and the Foundation. If you have questions about this report or need additional information, contact Deborah Ridlen, Vice President of Fiscal Services at 812-522-0171.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2013 AND 2012

ASSETS		
	<u>2013</u>	<u>2012</u>
Current assets		
Cash and cash equivalents	\$ 36,400,502	\$ 37,660,394
Investments	8,399,862	8,429,888
Patient accounts receivable, net of estimated uncollectibles of \$17,920,145 in 2013 and \$23,985,664 in 2012	27,976,300	16,041,927
Inventories	3,835,345	3,929,224
Prepaid expenses and other current assets	11,118,716	4,785,840
Physician recruitment guarantees, current portion	259,167	242,500
Other assets, current portion	678,662	894,033
Current portion of assets whose use is limited	<u>1,838,614</u>	<u>1,972,724</u>
Total current assets	90,507,168	73,956,530
Assets whose use is limited, net of amount required to meet current obligations	115,264,092	103,454,256
Capital assets		
Land	6,724,198	6,411,082
Land improvements	4,009,341	4,017,829
Leasehold improvements	672,661	672,661
Buildings	83,234,449	80,146,074
Fixed equipment	6,379,856	6,066,683
Movable equipment	<u>49,028,322</u>	<u>45,964,278</u>
	150,048,827	143,278,607
Less accumulated depreciation	<u>72,698,212</u>	<u>65,447,499</u>
	77,350,615	77,831,108
Construction in progress	<u>2,265,565</u>	<u>1,054,500</u>
Capital assets, net	79,616,180	78,885,608
Other long-term assets		
Physician recruitment guarantees, net of current portion	215,833	105,000
Other assets, net of current portion	<u>5,617,675</u>	<u>5,730,031</u>
Total other long-term assets	<u>5,833,508</u>	<u>5,835,031</u>
 Total assets	 <u>291,220,948</u>	 <u>262,131,425</u>
Deferred outflows - deferred loss on bond refunding	<u>1,984,591</u>	<u>851,704</u>
 Total assets and deferred outflows	 <u>\$ 293,205,539</u>	 <u>\$ 262,983,129</u>

See accompanying notes to consolidated financial statements.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2013 AND 2012

LIABILITIES AND NET POSITION

	2013	2012
Current liabilities		
Accounts payable	\$ 22,673,099	\$ 5,358,128
Accrued payroll and payroll withholdings	4,605,450	3,822,060
Accrued expenses	5,519,451	5,620,675
Estimated third-party payor settlements	7,519,030	7,125,000
Physician recruitment guarantees, current portion	259,167	242,500
Current portion of long-term debt	1,791,408	1,732,650
Total current liabilities	<u>42,367,605</u>	<u>23,901,013</u>
Long-term liabilities		
Long-term debt, net of current portion	35,918,119	48,373,905
Deferred compensation liabilities	7,534,110	5,921,642
Physician recruitment guarantees, net of current portion	215,833	105,000
Total long-term liabilities	<u>43,668,062</u>	<u>54,400,547</u>
 Total liabilities	 86,035,667	 78,301,560
Net position		
Invested in capital assets net of related debt	43,891,244	29,630,757
Restricted		
Expendable for debt service	3,673,887	4,820,700
Expendable for donor-designated purposes	1,484,306	1,227,722
Nonexpendable perpetual trust	336,528	306,945
Unrestricted	<u>157,783,907</u>	<u>148,695,445</u>
 Total net position	 <u>207,169,872</u>	 <u>184,681,569</u>
 Total liabilities and net position	 <u>\$ 293,205,539</u>	 <u>\$ 262,983,129</u>

See accompanying notes to consolidated financial statements.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
Operating revenues		
Net patient service revenue	\$ 192,202,363	\$ 125,133,074
Other revenue	<u>3,384,900</u>	<u>3,109,266</u>
Total operating revenues	195,587,263	128,242,340
Operating expenses		
Salaries and wages	84,019,114	49,582,498
Employee benefits and payroll taxes	12,790,821	12,268,898
Professional medical fees	1,421,327	1,274,609
Medical supplies	11,946,951	10,747,676
Other supplies	5,660,786	2,467,675
Drugs	8,334,756	6,993,318
Purchased services	22,717,468	10,561,821
Utilities	2,890,499	1,496,572
Insurance	2,049,649	1,270,282
Depreciation and amortization	8,868,277	8,740,769
Rent	8,678,436	1,074,339
Hospital assessment fee	4,731,229	5,816,239
Other operating expenses	<u>5,704,960</u>	<u>2,169,558</u>
Total operating expenses	<u>179,814,273</u>	<u>114,464,254</u>
Income from operations	15,772,990	13,778,086
Nonoperating revenues (expenses)	<u>6,715,313</u>	<u>3,132,552</u>
Change in net position	22,488,303	16,910,638
Net position, beginning of year	<u>184,681,569</u>	<u>167,770,931</u>
Net position, end of year	<u>\$ 207,169,872</u>	<u>\$ 184,681,569</u>

See accompanying notes to consolidated financial statements.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
Operating activities		
Cash received for patient services	\$ 180,662,020	\$ 124,748,339
Cash paid to/for employees	(94,414,077)	(60,794,274)
Cash paid to vendors and suppliers	(63,206,228)	(46,014,385)
Other receipts, net	3,384,900	3,109,266
Net cash flows from operating activities	26,426,615	21,048,946
Noncapital financing activities		
Noncapital contributions	547,323	504,616
Capital and related financing activities		
Principal payments on long-term debt	(12,197,295)	(1,647,377)
Interest paid	(1,646,208)	(1,895,510)
Purchase of capital assets	(10,143,084)	(4,568,022)
Proceeds from sale of capital assets	707,062	29,432
Change in bond premiums	(199,733)	(36,274)
Change in deferred outflows	(1,132,887)	93,336
Gain (loss) on disposal of capital assets	(60,486)	96,134
Net cash flows from capital and related financing activities	(24,672,631)	(7,928,281)
Investing activities		
Investment income	7,938,500	4,786,983
Other nonoperating revenues (expenses)	(124,302)	(263,537)
Change in investments	30,026	(6,429,888)
Change in assets whose use is limited	(6,012,039)	1,780,099
Change in other assets	270,303	(38,294)
Net cash flows from investing activities	2,102,488	(164,637)
Net change in cash and cash equivalents	4,403,795	13,460,644
Cash and cash equivalents, beginning of year	86,513,206	73,052,562
Cash and cash equivalents, end of year	\$ 90,917,001	\$ 86,513,206
Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents in current assets	\$ 36,400,502	\$ 37,660,394
Cash and cash equivalents in assets whose use is limited	54,516,499	48,852,812
Total cash and cash equivalents	\$ 90,917,001	\$ 86,513,206

See accompanying notes to consolidated financial statements.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
Reconciliation of income from operations to net cash and cash equivalents from operating activities		
Income from operations	\$ 15,772,990	\$ 13,778,086
Adjustments to reconcile income from operations to net cash flows from operating activities		
Depreciation	8,810,853	8,667,311
Amortization	57,424	73,458
Provision for bad debts	12,380,235	18,175,343
Changes in operating assets and liabilities		
Patient accounts receivable	(24,314,608)	(19,605,078)
Inventories	93,879	(130,956)
Prepaid expenses and other current assets	(6,332,876)	(4,120,714)
Accounts payable	17,270,054	2,302,274
Accrued payroll and payroll withholdings	783,390	612,453
Accrued expenses	(101,224)	(192,900)
Estimated third-party payor settlements	394,030	1,045,000
Deferred compensation liabilities	1,612,468	444,669
Net cash flows from operating activities	<u>\$ 26,426,615</u>	<u>\$ 21,048,946</u>
Supplemental disclosures of noncash operating and capital and related financing activities		
Property and equipment acquired included in accounts payable	\$ 44,917	\$ 850,495

See accompanying notes to consolidated financial statements.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

1. NATURE OF OPERATIONS

Jackson County Schneck Memorial Hospital (d/b/a Schneck Medical Center) (the "Hospital") is a not-for-profit, acute care hospital located in Seymour, Indiana. The Hospital is county owned and operates under the Indiana County Hospital Law, Indiana Code 16-22. The Hospital is organized for the purpose of providing healthcare services to the residents of Jackson County and the surrounding area. The Hospital's primary sources of support are from patient revenues and other ancillary income. Patient revenues include funds received from Medicare, state agencies, insurance companies, and the patients themselves.

Pursuant to the provision of long-term care, the Hospital owns the operations of eleven long term care facilities by way of an arrangement with the managers of the facilities. These facilities provide inpatient and therapy services. Generally, gross revenues from the operation of the facilities are the property of the Hospital and the Hospital is responsible for the associated operating expenses and working capital requirements. While the management and related lease agreements are in effect, the performance of all activities of the managers shall be on behalf of the Hospital and the Hospital retains the authority for the operation of the facilities.

During 2012 and 2013, the Hospital entered into lease agreements with the long-term care facilities, collectively referred to as the Lessors, to lease the facilities managed by the Managers. Concurrently, the Hospital entered into agreements with the Managers to manage the above leased facilities. As part of the agreements, the Hospital will pay the Managers a management fee to continue managing the facilities on behalf of the Hospital in accordance with the terms of the agreements. These management fees consist of base management fees, subordinated management fees, and quarterly incentive payments. The agreements' initial terms expire at various times in 2015. The terms of these agreements may be renewed at the end of each term for an additional period of two years. All parties involved can terminate the agreement without cause with 90 days written notice.

Other current assets and liabilities include certain reimbursement receivables, accrued fees and expenses, and working capital balances related to the long-term care facilities.

Health Development Corporation ("HDC") is a not-for-profit corporation located in Seymour, Indiana. HDC was organized to operate exclusively for the benefit of, to perform the functions of, and to carry out the purposes of the Hospital by recruiting physicians to the surrounding area and by providing medical education programs to the medical and Hospital staff. HDC's primary sources of revenue are from service fees charged to the Hospital.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

HDC's consolidated financial statements at December 31, 2013 and 2012, include the accounts of Coordinated Health, LLC (the "Clinic"). The Clinic is wholly-owned by HDC and began operations in 2002. The Clinic was organized to operate exclusively for the benefit of HDC and the purposes for which HDC is organized and operated, including the promotion and support of the health of Jackson County, Indiana residents and residents of surrounding communities. Currently, the Clinic operates three healthcare facilities located in North Vernon, Salem, and Scottsburg, Indiana. The Clinic's primary source of revenue is from patient services.

The Jackson County Schneck Memorial Hospital Foundation, Inc. (d/b/a Schneck Medical Center Foundation) (the "Foundation") is a not-for-profit organization located in Seymour, Indiana. The Foundation operates for the benefit of the Hospital. The Foundation's main sources of revenue are earnings on investments, donations received, and rental income.

Jackson Medical Building, LLC ("JMB") is a limited liability company that is wholly owned by the Hospital. JMB was organized to own and operate a medical office building located on the Hospital's campus. JMB's primary source of revenue is from rental income.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by the Hospital, HDC, JMB, and the Foundation (collectively the "Medical Center") in the preparation of the consolidated financial statements are summarized below:

Reporting Entity and Consolidation Policy

The accompanying consolidated financial statements include the accounts of the Hospital, HDC, the Clinic, JMB, and the Foundation. The Board of County Commissioners of Jackson County appoints the governing Board of Trustees of the Hospital, and a financial benefit/burden relationship exists between the Hospital and the Jackson County government. For these reasons, the Hospital is considered a component unit of Jackson County. Similarly, due to their organized purposes, HDC, the Clinic, JMB, and the Foundation are considered blended component units of the Hospital. Intercompany transactions and balances have been eliminated in consolidation. The separate audited financial statements of HDC (including the Clinic) and the Foundation may be obtained by contacting the Hospital as follows:

Schneck Medical Center
411 W. Tipton Street
P.O. Box 2349
Seymour, IN 47274

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Management's Estimates

Management uses estimates and assumptions in preparing the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, if any, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

Proprietary Fund Accounting

The Medical Center utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis of accounting using the economic resources measurement focus. Substantially all revenues and expenses are subject to accrual.

New Accounting Standards

During 2013, the Medical Center implemented GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which established accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities. For certain transactions resulting in defeasance of debt reported by the Medical Center, the difference between the reacquisition price and the net carrying amount of the old debt should now be reported as a deferred outflow of resources or a deferred inflow of resources and recognized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter. Previously, such amounts were included as a component of the long-term debt liability. In addition, debt issuance costs should now be recognized as an expense in the period incurred. Previously, debt issuance costs were capitalized at issuance and amortized over the term of the related debt.

The 2012 financial statements have been retroactively restated to address the implementation of this new standard and the effects on the financial statements are detailed below:

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

	December 31, 2012		
	Previously Reported	Adjustment	Restated
Consolidated balance sheet			
Prepaid expenses and other current assets	\$ 4,772,255	\$ 13,585	\$ 4,785,840
Other assets	\$ 7,257,770	\$ (633,706)	\$ 6,624,064
Total assets	\$ 262,751,546	\$ (620,121)	\$ 262,131,425
Deferred outflows	\$ -0-	\$ 851,704	\$ 851,704
Total assets and deferred outflows	\$ 262,751,546	\$ 231,583	\$ 262,983,129
Accounts payable	\$ 5,344,543	\$ 13,585	\$ 5,358,128
Long-term debt	\$ 49,254,851	\$ 851,704	\$ 50,106,555
Total liabilities	\$ 77,436,271	\$ 865,289	\$ 78,301,560
Unrestricted	\$ 149,329,151	\$ (633,706)	\$ 148,695,445
Total net position	\$ 185,315,275	\$ (633,706)	\$ 184,681,569
Total liabilities and net position	\$ 262,751,546	\$ 231,583	\$ 262,983,129
Consolidated statement of operations and changes in net position			
Depreciation and amortization	\$ 8,818,724	\$ (77,955)	\$ 8,740,769
Total expenses	\$ 114,542,209	\$ (77,955)	\$ 114,464,254
Operating income	\$ 13,700,131	\$ 77,955	\$ 13,778,086
Change in net position	\$ 16,832,683	\$ 77,955	\$ 16,910,638
Net position, December 31, 2011	\$ 168,482,592	\$ (711,661)	\$ 167,770,931
Consolidated statement of cash flows			
Amortization	\$ 151,413	\$ (77,955)	\$ 73,458
Change in net position	\$ 13,700,131	\$ 77,955	\$ 13,778,086

During 2013, the Medical Center implemented GASB No. 61, The Financial Reporting Entity: Omnibus, an amendment of GASB Statements No. 14, the Financial Reporting Entity, and 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments. The objective of the implementation is to improve financial reporting for a governmental financial reporting entity. As discussed in Note 25 to the consolidated financial statements, the Medical Center adopted GASB Statement No. 61 which requires reporting condensed combining information in the notes to the financial statements for blended component units of primary governments that are business-type activities.

Risk Management

The Medical Center is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The Medical Center is insured for medical malpractice claims and judgments.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Cash and Cash Equivalents

Cash and cash equivalents as reported on the consolidated balance sheets include petty cash and other cash on hand amounts, checking accounts, and savings accounts that are readily available for use. Cash and cash equivalents as reported on the consolidated statements of cash flows include investments in highly liquid assets with maturity dates of 90 days or less when purchased.

Investments

Investments include certificates of deposit amounts maturing within one year of the dates of the consolidated balance sheets. Investments are recorded at cost, which approximates market value.

Patient Accounts Receivable and Net Patient Service Revenue

The Medical Center recognizes net patient service revenues on the accrual basis of accounting in the reporting period in which services are performed based on the current gross charge structure, less actual adjustments and estimated discounts for contractual allowances, principally for patients covered by Medicare, Medicaid, managed care, and other health plans. Gross patient service revenue is recorded in the accounting records using the established rates for the types of service provided to the patient. The Medical Center recognizes an estimated contractual allowance to reduce gross patient charges to the estimated net realizable amount for service rendered based upon previously agreed-to rates with a payor. The Medical Center utilizes the patient accounting system to calculate contractual allowances on a payor-by-payor basis based on the rates in effect for each primary third-party payor. Another factor that is considered and could further influence the level of the contractual reserves includes the status of accounts receivable balances as inpatient or outpatient. The Medical Center's management continually reviews the contractual estimation process to consider and incorporate updated laws and regulations and the frequent changes in managed care contractual terms that result from contract negotiations and renewals.

Payors include federal and state agencies, including Medicare and Medicaid, managed care health plans, commercial insurance companies, and patients. These third-party payors provide payments to the Medical Center at amounts different from its established rates based on negotiated reimbursement agreements. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and fee schedule payments. Retroactive adjustments under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Allowance for Doubtful Accounts

Accounts receivable are reduced by an allowance for doubtful accounts based on the Medical Center's evaluation of its major payor sources of revenue, the aging of the accounts, historical losses, current economic conditions, and other factors unique to the service area and the healthcare industry. Management regularly reviews data about the major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party payor coverage, the Medical Center analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulty that make the realization of amounts due unlikely). For receivables associated with self-pay payments, which includes both patients without insurance and patient with deductible and copayment balances due for which third-party coverage exists for part of the bill, the Medical Center records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible.

The Medical Center's current allowance for doubtful accounts policy is to reserve 85 percent of self-pay accounts less than 150 days, 100 percent of self-pay accounts 150 and older, and 100 percent of all other payor accounts 150 days and older, net of contractual allowances already taken. The December 31, 2013 allowance for doubtful accounts balances were comprised of the following:

	<u>2013</u>	<u>2012</u>
Reserve for third-party payor balances	\$ 2,232,591	\$ 3,530,376
Reserve for self-pay balances	<u>15,687,554</u>	<u>20,455,288</u>
Total allowance for doubtful accounts	<u>\$ 17,920,145</u>	<u>\$ 23,985,664</u>

Inventories

Inventories consist of medical supplies, pharmaceuticals, and office supplies and are valued at the lower of cost or market, with cost being determined on the first-in, first-out (FIFO) method.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Assets Whose Use is Limited

Investments in certificates of deposit are reported in the consolidated financial statements at cost, which approximates fair value.

Assets whose use is limited include assets set aside by the respective Boards for future capital improvements, over which the Boards retain control and may at their discretion subsequently use for other purposes; assets held by trustees under indenture agreements; assets that have been restricted by donors for specific purposes; and amounts that have been set aside as part of deferred compensation plans.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair market value in the consolidated balance sheets. Investment income or loss, including realized gains and losses on investments and assets whose use is limited, net change in the market value of assets whose use is limited, interest, and dividends, is included in nonoperating revenues (expenses) when earned.

Capital Assets

The Medical Center's capital assets are reported at historical cost and include expenditures for additions and repairs which substantially increase the useful lives of capital assets. Maintenance, repairs, and minor improvements are expensed as incurred. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land and construction in progress are depreciated using the straight-line method of depreciation over their estimated useful lives based upon the American Hospital Association Guide for Estimated Useful Lives for Fixed Assets.

Costs of Borrowing

Except for capital assets acquired through gifts, contributions, or capital grants, interest costs on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. For the years ended December 31, 2013 and 2012, the Medical Center capitalized interest costs of \$107,376 and \$46,586, respectively.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Classification of Net Position

The net position of the Medical Center is classified in four components. (1) *Invested in capital assets net of related debt* consists of capital assets net of accumulated depreciation plus deferred outflows related to losses on bond refunding which are reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. (2) *Restricted expendable net position* includes assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center, including amounts deposited with trustees as required by revenue bond indentures. (3) *Restricted nonexpendable net position* includes the principal portion of permanent endowments and non-controlling interests owned by external investors. (4) *Unrestricted net position* is the remaining net position that does not meet the definition of *invested in capital assets net of related debt* or *restricted*.

Consolidated Statements of Operations and Changes in Net Position

For purposed of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenues and expenses. Peripheral and incidental transactions are reported as nonoperating revenues (expenses). Nonoperating revenues (expenses) which are excluded from income from operations include investment income, contributions received, restricted expenditures, and the net change in the market value of assets whose use is limited.

Advertising and Marketing Costs

Advertising and marketing costs are charged to operations when incurred. Advertising and marketing costs charged to operations were \$1,008,269 and \$745,423 for the years ended December 31, 2013 and 2012, respectively.

Income Taxes

The Hospital has been granted exemption from taxation as a not-for-profit organization by the Internal Revenue Service under Section 115, and in 2005 was also granted exemption from Federal income tax under Section 501(c)(3) of the Internal Revenue Code for purposes of maintaining a 403b deferred compensation plan. Therefore, no provision for income taxes has been provided in the consolidated statements of operations and changes in net position. HDC and the Foundation are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. As such HDC and the Foundation are generally exempt from income taxes. However, HDC and the Foundation are required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only. The Clinic and JMB are both organized as a single-member Limited Liability Company (LLC). As

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

of December 31, 2013, the 2009 - 2013 income tax years are still open for tax examinations for both the Clinic and JMB. HDC is the sole member of the Clinic, and the Hospital is the sole member of JMB. As such, the Clinic and JMB are not required to file separate State or Federal tax returns. For tax reporting purposes, all activities of the Clinic are required to be filed with the activities of HDC, and all activities of JMB are required to be filed with the activities of the Hospital.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by each entity comprising the Medical Center and recognize a tax liability if any Medical Center entity has taken an uncertain tax position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by each entity of the Medical Center, and has concluded that as of December 31, 2013 and 2012, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. Each entity of the Medical Center is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

Grants and Contributions

From time to time, the Medical Center receives grants as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues.

Physician Recruitment Guarantees

The Financial Accounting Standards Board (FASB) has issued accounting standards which require the Medical Center to report a liability for physician revenue guarantees on its consolidated balance sheets at fair value and amortize that liability and corresponding intangible asset over the income guarantee period. As cash payments are made to the physicians in accordance with the terms of the income guarantees, the Medical Center records a note receivable from each participating physician. These notes are either paid back to the Medical Center or are forgiven by the Medical Center in accordance with the terms of each separate income guarantee agreement. As of December 31, 2013 and 2012, the Medical Center had matching assets and liabilities relating to physician guarantees of \$475,000 and \$347,500, respectively.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Subsequent Events

The Medical Center has evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued, which is April 28, 2014.

Reclassifications

Certain 2012 amounts have been reclassified to provide for consistency with reporting of 2013 information. These reclassifications have no effect on the previously reported change in net position or net position.

3. DEPOSITS AND INVESTMENTS

Deposits and investments are comprised of the following at December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Carrying amount		
Cash and cash equivalents	\$ 90,917,001	\$ 86,513,206
Certificates of deposit	23,000,000	26,066,000
Mutual funds	46,206,848	37,324,896
Corporate bonds	79,525	110,112
Perpetual trust	336,528	306,945
Interest receivable	28,939	39,989
Fixed income guaranteed option	510,537	467,490
Common stocks	<u>823,692</u>	<u>688,624</u>
Total	<u>\$ 161,903,070</u>	<u>\$ 151,517,262</u>
Included in the consolidated balance sheet captions:		
Cash and cash equivalents	\$ 36,400,502	\$ 37,660,394
Investments	8,399,862	8,429,888
Assets whose use is limited	<u>117,102,706</u>	<u>105,426,980</u>
Total	<u>\$ 161,903,070</u>	<u>\$ 151,517,262</u>

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the Medical Center's deposits may not be returned to it. The Medical Center does not have a deposit policy for custodial credit risk. Deposits with financial institutions are insured by the Federal Depositary Insurance Corporation ("FDIC") up to FDIC limits. This includes any deposit accounts issued or offered by a qualifying institution.

Investments are carried at fair value or cost which approximates fair value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. As of December 31, 2013 and 2012, the Medical Center had the following investments and maturities, all of which were held in the Medical Center's name by custodial banks or investment companies that are agents of the Medical Center:

December 31, 2013					
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1 - 5	6 - 10	More than 10
Certificates of deposit	\$ 23,000,000	\$ 23,000,000	\$ -0-	\$ -0-	\$ -0-
Corporate bonds	79,525	9,246	67,893	2,386	-0-
Total	\$ 23,079,525	\$ 23,009,246	\$ 67,893	\$ 2,386	\$ -0-

December 31, 2012					
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1 - 5	6 - 10	More than 10
Certificates of deposit	\$ 26,066,000	\$ 26,066,000	\$ -0-	\$ -0-	\$ -0-
Corporate bonds	110,112	7,260	80,288	22,564	-0-
Total	\$ 26,176,112	\$ 26,073,260	\$ 80,288	\$ 22,564	\$ -0-

Interest Rate Risk

Interest risk rate is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

The Medical Center does have formal investment policies that limit investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates. The Hospital's current investment policy limits investments with maturities of two years or longer to no more than 60 percent of total investments. The Foundation's investment policy prohibits the purchase of fixed income securities with original maturities of more than 10 years, unless the securities are part of a fund portfolio which has an average maturity of not greater than 10 years.

Credit Risk – Investments

Credit risk is the risk that, in the event of a failure of a financial institution, the Medical Center would not be able to recover deposits, the value of its investments, or collateral securities that are in the possession of an outside party.

Statutes authorize the Medical Center to invest in interest-bearing deposit accounts, passbook savings accounts, certificates of deposit, money market deposit accounts, repurchase agreements, mutual funds, pooled fund investments, and securities backed by the full faith and credit of the United States Treasury. The statutes require that repurchase agreements be fully collateralized by U.S. Government or U.S. Government Agency obligations.

Investment Type	Credit Rating Moody's	Fair Value 2013	Fair Value 2012
Corporate bonds	A1	\$ 8,986	\$ 14,224
Corporate bonds	A2	6,768	5,247
Corporate bonds	A3	13,537	19,045
Corporate bonds	Aaa	2,308	2,477
Corporate bonds	Aa2	4,622	4,900
Corporate bonds	Aa3	2,288	2,403
Corporate bonds	Baa1	14,191	28,076
Corporate bonds	Baa2	10,771	19,387
Corporate bonds	Baa3	16,054	14,353
		<u>\$ 79,525</u>	<u>\$ 110,112</u>

Concentration of Credit Risk

The Hospital places no limit on the amount it may invest in any one issuer. The Foundation limits investments in securities of a single issuer to 10 percent of the portfolio's total market value. This limitation does not include U.S. Government Securities. The Medical Center maintains its investments, which at times may exceed federally insured limits. The Medical Center has not experienced any losses in such accounts. The Medical Center believes that it is not exposed to any significant credit risk on investments.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Fair Value Measurements and Disclosures

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active market for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described as follows:

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Medical Center has the ability to access.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2013 and 2012.

- *Mutual funds*: Valued at the daily closing price as reported by the fund. Mutual funds held by the Medical Center are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. The mutual funds held by the Medical Center are deemed to be actively traded.
- *Corporate bonds*: Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.
- *Perpetual trust*: Valued at fair value as reported by the trustee, which represents the Medical Center's *pro rata* interest in the net position of the trust, substantially all of which are valued on a mark-to-market basis.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

- *Fixed income guaranteed option:* Guaranteed investment contracts are valued at fair value by the insurance company by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the creditworthiness of the issuer. Since the participants transact at contract value, fair value is determined annually for financial statement reporting purposes only. In determining the reasonableness of the methodology the Finance Committee evaluates a variety of factors including review of existing contracts, economic conditions, industry and market developments, and overall credit ratings. Certain unobservable inputs are assessed through review of contract terms (for example, duration or payout date) while others are substantiated utilizing available market data (for example, swap curve rate).
- *Common stocks:* Valued at the closing price reported on the active market on which the individual securities are traded.
- *Deferred compensation:* Value based on the underlying investments.
- *Money market funds:* Generally transact subscription and redemption activity at a \$1 stable net asset value (NAV) however, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of the securities held in the fund.

The following table set forth by level, within the hierarchy, the Medical Center's asset measured at fair value on a recurring basis as of December 31, 2013 are as follows:

	Level 1	Level 2	Level 3	Total
Assets				
Corporate bonds				
Energy	\$ -0-	\$ 2,308	\$ -0-	\$ 2,308
Financial	-0-	37,546	-0-	37,546
Healthcare	-0-	9,207	-0-	9,207
Basic materials	-0-	4,524	-0-	4,524
Utilities	-0-	4,217	-0-	4,217
Services	-0-	21,723	-0-	21,723
	-0-	79,525	-0-	79,525
Common stocks				
Basic materials	145,367	-0-	-0-	145,367
Consumer goods	103,874	-0-	-0-	103,874
Consumer services	70,070	-0-	-0-	70,070
Financials	180,625	-0-	-0-	180,625
Healthcare	103,105	-0-	-0-	103,105
Industrials	96,375	-0-	-0-	96,375
Technology	121,537	-0-	-0-	121,537
Utilities	2,739	-0-	-0-	2,739
	823,692	-0-	-0-	823,692

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Mutual funds				
Large cap value	4,621,813	-0-	-0-	4,621,813
Large cap blend	11,153,176	-0-	-0-	11,153,176
Large cap growth	4,942,736	-0-	-0-	4,942,736
Mid cap value	2,039,288	-0-	-0-	2,039,288
Mid cap blend	1,284,262	-0-	-0-	1,284,262
Mid cap growth	46,613	-0-	-0-	46,613
Small cap value	18,348	-0-	-0-	18,348
Small cap blend	2,232,806	-0-	-0-	2,232,806
Small cap growth	9,869	-0-	-0-	9,869
Foreign small growth	1,647,119	-0-	-0-	1,647,119
Foreign large value	106,413	-0-	-0-	106,413
Foreign large blend	5,271,343	-0-	-0-	5,271,343
World stock	5,650,520	-0-	-0-	5,650,520
Intermediate term bond	1,132,618	-0-	-0-	1,132,618
Short term bond	317,890	-0-	-0-	317,890
Intermediate government	502,196	-0-	-0-	502,196
Short government	4,466	-0-	-0-	4,466
High yield bond	786,624	-0-	-0-	786,624
Inflation protected bond	1,712,699	-0-	-0-	1,712,699
Natural resources	1,136,055	-0-	-0-	1,136,055
Realty funds	1,589,994	-0-	-0-	1,589,994
	<u>46,206,848</u>	<u>-0-</u>	<u>-0-</u>	<u>46,206,848</u>
Money market funds	-0-	3,798,847	-0-	3,798,847
Perpetual trust, held by trustee	-0-	-0-	336,528	336,528
Fixed income guaranteed option	-0-	510,537	-0-	510,537
Total assets at fair value	<u>\$ 47,030,540</u>	<u>\$ 590,062</u>	<u>\$ 336,528</u>	<u>51,755,977</u>
Cash				87,118,154
Certificates of deposit				23,000,000
Interest receivable				28,939
Total deposits and investments				<u>\$ 161,903,070</u>

Liabilities

Deferred compensation liabilities	<u>\$ -0-</u>	<u>\$ (7,534,110)</u>	<u>\$ -0-</u>	<u>\$ (7,534,110)</u>
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The following table set forth by level, within the hierarchy, the Medical Center's asset measured at fair value on a recurring basis as of December 31, 2012 are as follows:

	Level 1	Level 2	Level 3	Total
<u>Assets</u>				
Corporate bonds				
Energy	\$ -0-	\$ 6,831	\$ -0-	\$ 6,831
Financial	-0-	58,466	-0-	58,466
Healthcare	-0-	9,722	-0-	9,722
Industrials	-0-	10,891	-0-	10,891
Materials	-0-	4,760	-0-	4,760
Services	-0-	19,442	-0-	19,442
	<u>-0-</u>	<u>110,112</u>	<u>-0-</u>	<u>110,112</u>

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Common stocks				
Basic materials	113,940	-0-	-0-	113,940
Consumer goods	69,517	-0-	-0-	69,517
Consumer services	70,424	-0-	-0-	70,424
Financials	83,872	-0-	-0-	83,872
Healthcare	81,085	-0-	-0-	81,085
Industrials	96,621	-0-	-0-	96,621
Materials	18,761	-0-	-0-	18,761
Technology	118,683	-0-	-0-	118,683
Utilities	35,721	-0-	-0-	35,721
	<u>688,624</u>	<u>-0-</u>	<u>-0-</u>	<u>688,624</u>
Mutual funds				
Large cap value	4,096,338	-0-	-0-	4,096,338
Large cap blend	2,789,901	-0-	-0-	2,789,901
Large cap growth	5,126,723	-0-	-0-	5,126,723
Large cap index	1,853,156	-0-	-0-	1,853,156
Mid cap value	51,053	-0-	-0-	51,053
Mid cap blend	705,128	-0-	-0-	705,128
Mid cap growth	32,844	-0-	-0-	32,844
Small cap value	752,631	-0-	-0-	752,631
Small cap blend	513,124	-0-	-0-	513,124
Small cap growth	1,370,326	-0-	-0-	1,370,326
Small cap index	1,352,484	-0-	-0-	1,352,484
Foreign large value	1,754,231	-0-	-0-	1,754,231
Foreign large blend	1,529,233	-0-	-0-	1,529,233
World stock	3,058,416	-0-	-0-	3,058,416
Intermediate term bond	2,952,531	-0-	-0-	2,952,531
Short term bond	13,541	-0-	-0-	13,541
Intermediate government	8,576	-0-	-0-	8,576
Short government	2,313,938	-0-	-0-	2,313,938
High yield bond	705,128	-0-	-0-	705,128
International equity	2,680,712	-0-	-0-	2,680,712
Foreign bond	659,285	-0-	-0-	659,285
Specialty funds	1,546,976	-0-	-0-	1,546,976
Realty funds	1,458,621	-0-	-0-	1,458,621
	<u>37,324,896</u>	<u>-0-</u>	<u>-0-</u>	<u>37,324,896</u>
Money market funds	-0-	4,955,564	-0-	4,955,564
Perpetual trust, held by trustee	-0-	-0-	306,945	306,945
Fixed income guaranteed option	-0-	467,490	-0-	467,490
Total assets at fair value	<u>\$ 38,013,520</u>	<u>\$ 5,533,166</u>	<u>\$ 306,945</u>	<u>43,853,631</u>
Cash				81,557,642
Certificates of deposit				26,066,000
Interest receivable				39,989
Total deposits and investments				<u>\$ 151,517,262</u>
<u>Liabilities</u>				
Deferred compensation liabilities	<u>\$ -0-</u>	<u>\$ (5,921,642)</u>	<u>\$ -0-</u>	<u>\$ (5,921,642)</u>

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

The Medical Center's policy is to recognize transfers between levels as of the end of the reporting period. There were no significant transfers between levels 1 and 2 during 2013 and 2012.

The following summary sets forth a summary of changes in the fair values of the Medical Center's Level 3 assets for the year ended December 31, 2013:

	<u>Perpetual Trust Held by Trustee</u>
Balance, beginning of the year	\$ 306,945
Purchase of investments	-0-
Redemption	-0-
Change in investment value	<u>29,583</u>
Balance, end of year	<u>\$ 336,528</u>

The following summary sets forth a summary of changes in the fair values of the Medical Center's Level 3 assets for the year ended December 31, 2012:

	<u>Perpetual Trust Held by Trustee</u>
Balance, beginning of the year	\$ 285,671
Purchase of investments	-0-
Redemption	-0-
Change in investment value	<u>21,274</u>
Balance, end of year	<u>\$ 306,945</u>

Investments in the Perpetual Trust are recorded at fair value as reported by the trust administrator, which represents the Medical Center's pro rata interest in the net position of the Trust, substantially all of which are valued on a market-to-market basis.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

4. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable reported as current assets at December 31, 2013 and 2012, consist of the following:

	2013	2012
Medicare	\$ 15,050,917	\$ 10,536,208
Medicaid	10,176,573	5,501,980
Blue Cross	6,191,265	7,021,237
Other insurance carriers	12,358,493	10,356,581
Patients	17,453,307	22,091,870
Total patient accounts receivable	61,230,555	55,507,876
Less allowance for contractals	15,334,110	15,480,285
Less allowance for uncollectible amounts	17,920,145	23,985,664
Patient accounts receivable, net	<u>\$ 27,976,300</u>	<u>\$ 16,041,927</u>

5. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. Assets whose use is limited are reported at market value and include the following at December 31, 2013 and 2012:

Investment Summary by Type

	2013	%	2012	%
Cash and cash equivalents	\$ 54,516,499	46.6 %	\$ 48,852,812	46.3 %
Interest receivable	28,939	0.0	39,989	0.0
Certificates of deposit	15,000,000	12.8	18,066,000	17.1
Corporate bonds	79,525	0.1	110,112	0.1
Common stocks	623,761	0.5	473,680	0.5
Fixed income guaranteed option	510,537	0.4	467,490	0.5
Mutual funds	46,006,917	39.3	37,109,952	35.2
Perpetual trust, held by trustee	336,528	0.3	306,945	0.3
Total assets whose use is limited	\$ 117,102,706	<u>100.0 %</u>	\$ 105,426,980	<u>100.0 %</u>
Less amount required for current obligations	<u>1,838,614</u>		<u>1,972,724</u>	
Assets whose use is limited, net of amount required to meet current obligations	<u>\$ 115,264,092</u>		<u>\$ 103,454,256</u>	

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Investment Summary by Fund

Board-Designated Funds	\$ 104,073,875	88.9 %	\$ 93,149,971	88.4 %
Trustee-Held Funds	3,673,887	3.1	4,820,700	4.5
Donor-Restricted Funds	1,820,834	1.6	1,534,667	1.5
Deferred Compensation Funds	7,534,110	6.4	5,921,642	5.6
Total	<u>\$ 117,102,706</u>	<u>100.0 %</u>	<u>\$ 105,426,980</u>	<u>100.0 %</u>

Board-Designated Funds

The Hospital's Board of Trustees approved the funding of depreciation expense to meet the capital asset replacement needs of the facility. Depreciation is funded totally with expenditures for capital items reducing the funded depreciation balance. Board-designated funds also include amounts intended for specific purposes, as established by the Hospital's, HDC's, and Foundation's separate Boards. All income earned by the board-designated accounts is left to accumulate as additions to the funds. Board-designated funds remain under the control of the separate Boards, which may at their discretion later use for other purposes. Therefore, all board-designated funds are included in unrestricted net position.

Trustee-Held Funds

The trustee-held funds are restricted for the payments of principal and interest related to certain long-term debt agreements.

Donor-Restricted Funds

Donor-restricted funds represent donations that have been restricted by donors for specific purposes.

Deferred Compensation Funds

The deferred compensation funds represent assets that have accumulated under the Medical Center's deferred compensation plan. The Medical Center simply maintains the funds for the participants until they are withdrawn. The Medical Center records a liability equal to the deferred compensation assets.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

6. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2013 and 2012, was as follows:

	2013			
	Beginning Balance	Additions	Retirements/ Transfers	Ending Balance
Land	\$ 6,411,082	\$ 408,078	\$ (94,962)	\$ 6,724,198
Land improvements	4,017,829	12,950	(21,438)	4,009,341
Leasehold improvements	672,661	-0-	-0-	672,661
Buildings	80,146,074	787,923	2,300,452	83,234,449
Fixed equipment	6,066,683	87,672	225,501	6,379,856
Movable equipment	45,964,278	2,223,579	840,465	49,028,322
Construction in progress	1,054,500	6,667,799	(5,456,734)	2,265,565
Total historical cost	144,333,107	10,188,001	(2,206,716)	152,314,392
Less accumulated depreciation for				
Land improvements	(1,713,102)	(257,078)	19,992	(1,950,188)
Leasehold improvements	(353,932)	(123,136)	-0-	(477,068)
Buildings	(26,272,004)	(3,626,018)	8,466	(29,889,556)
Fixed equipment	(4,763,010)	(255,127)	294,666	(4,723,471)
Movable equipment	(32,345,451)	(4,549,494)	1,237,016	(35,657,929)
Total accumulated depreciation	(65,447,499)	(8,810,853)	1,560,140	(72,698,212)
Capital assets, net	<u>\$ 78,885,608</u>	<u>\$ 1,377,148</u>	<u>\$ (646,576)</u>	<u>\$ 79,616,180</u>

	2012			
	Beginning Balance	Additions	Retirements/ Transfers	Ending Balance
Land	\$ 6,333,966	\$ -0-	\$ 77,116	\$ 6,411,082
Land improvements	3,980,415	58,586	(21,172)	4,017,829
Leasehold improvements	930,537	22,984	(280,860)	672,661
Buildings	77,786,900	305,574	2,053,600	80,146,074
Fixed equipment	5,903,751	206,054	(43,122)	6,066,683
Movable equipment	42,792,862	2,781,962	389,454	45,964,278
Construction in progress	2,332,925	2,043,357	(3,321,782)	1,054,500
Total historical cost	140,061,356	5,418,517	(1,146,766)	144,333,107
Less accumulated depreciation for				
Land improvements	(1,461,224)	(257,347)	5,469	(1,713,102)
Leasehold improvements	(369,021)	(124,093)	139,182	(353,932)
Buildings	(22,764,559)	(3,610,838)	103,393	(26,272,004)
Fixed equipment	(4,565,349)	(241,432)	43,771	(4,763,010)
Movable equipment	(28,641,235)	(4,433,601)	729,385	(32,345,451)
Total accumulated depreciation	(57,801,388)	(8,667,311)	1,021,200	(65,447,499)
Capital assets, net	<u>\$ 82,259,968</u>	<u>\$ (3,248,794)</u>	<u>\$ (125,566)</u>	<u>\$ 78,885,608</u>

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

7. OTHER ASSETS

At December 31, 2013 and 2012, other assets consist of the following:

	2013	2012
Prepaid pension costs	\$ 1,984,577	\$ 2,002,252
Physician notes receivable	1,365,354	1,762,269
Notes receivable	6,401	44,136
Investment in managed care company	755,000	755,000
Investment in RCG Columbus, LLC	974,900	974,900
Investment in captive insurance company	335,311	335,311
Captive insurance company subscriber savings	820,303	635,834
Other	54,491	114,362
Total other assets	6,296,337	6,624,064
Other assets, current portion	(678,662)	(894,033)
Other assets, net of current portion	<u>\$ 5,617,675</u>	<u>\$ 5,730,031</u>

Physician notes receivable are in varying amounts maturing through February 2019. If the physicians meet the period of service requirement, the Medical Center will forgive these notes. If the physicians do not meet the period-of-service requirement, the notes are immediately due in full. Interest rates are prime rate + 1 to prime rate + 2 percent (4.25 and 5.25 percent, respectively, at December 31, 2013).

The Medical Center is a partial owner of a healthcare managed care company. The Medical Center has a one-sixth voting interest in the managed care company and accounts for its investment using the cost method.

The Medical Center made a \$974,900 contribution to purchase a 12.25 percent ownership interest in RCG Columbus, LLC ("RCG"). RCG provides renal care to patients. The Medical Center's investment in RCG is being accounted for under the cost method.

The Medical Center is a 12.5 percent owner of Indiana Healthcare Reciprocal Risk Retention Group (the "Captive"), a risk retention company created to purchase professional liability and general liability insurance for its members. The Medical Center accounts for this investment using the cost method. In addition, the Captive retains a subscriber savings account for each of its members based upon the premiums paid in and the resulting claims paid out, plus other factors. Members are paid the balance of their subscriber savings account once they leave the Captive in accordance with the terms of the Captive agreement.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

8. COMPENSATED ABSENCES

The Medical Center provides a paid time off (PTO) policy to employees for vacation, sick time, personal days, and holidays. Upon employment, full and part-time employees who are budgeted, scheduled, and work at least 37.5 hours per pay period accrue PTO from the date of hire. After completion of 6 months of service as a benefit eligible employee, PTO may be used with pay for the total amount accrued.

The rate at which full-time employees earn PTO and the maximum number of hours that may be banked are as follows:

<u>Employee Type</u>	<u>Length of Service</u>	<u>PTO earned for each hour paid</u>	<u>Maximum PTO bank</u>
General	0 - 2 years	0.0885	368 hours
General	2 - 10 years	0.1077	448 hours
General	10 or more years	0.1270	528 hours
Directors	0 - 2 years	0.1077	448 hours
Directors	2 or more years	0.1270	528 hours
Vice Presidents	Upon hire	0.1462	608 hours

PTO days are accrued when incurred. The PTO accrual at December 31, 2013 and 2012 was \$3,811,542 and \$3,794,571, respectively and is reported in accrued expenses in the consolidated financial statements.

9. EMPLOYEE HEALTH BENEFIT PLAN

The Medical Center operates a self-funded health plan covering substantially all employees. The Medical Center has an annual stop loss limit on the plan of \$100,000 per insured per year and an aggregate stop loss limit of approximately \$8,800,000. The total annual exposure including claims, administration fees, and stop loss premiums is approximately \$9,900,000. Claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. Claims liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of pay out, and other economic and social factors. The accrued liability for claims liabilities is recorded in accrued expenses on the consolidated balance sheets.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Changes in the balance of claims liabilities during the years ended December 31, 2013 and 2012, were as follows:

	<u>2013</u>	<u>2012</u>
Accrued liability, beginning of year	\$ 1,197,687	\$ 1,189,029
Incurred claims, changes in estimates, and fees/premiums	7,673,539	7,196,188
Claim payments	<u>(7,603,552)</u>	<u>(7,187,530)</u>
Accrued liability, end of year	<u>\$ 1,267,674</u>	<u>\$ 1,197,687</u>

10. DEFINED BENEFIT PENSION PLAN

Plan Description

The Medical Center sponsors a single-employer, defined benefit pension plan covering all employees that are at least twenty-one years old and have at least one year of eligibility service. Benefit provisions are established or may be amended at any time by the action of the Plan's Board of Trustees. The Medical Center functions as the plan administrator of the defined benefit pension plan, as authorized by IC 16-22-3-11. A publicly available financial report that includes the defined benefit pension plan's financial statements and required supplementary information may be obtained by contacting:

Schneck Medical Center
P.O. Box 2349
Seymour, IN 47274
Ph. (812) 522-0118

Funding Policy

No contributions from active plan members are required or permitted. The Internal Revenue Service has determined that the plan is a government plan which is not subject to ERISA minimum funding requirements.

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Annual Pension Cost and Net Pension Obligation

The Medical Center's annual pension cost and net pension obligation for the years ended December 31, 2013 and 2012, are as follows:

	<u>2013</u>	<u>2012</u>
Annual required contribution	\$ -0-	\$ -0-
Interest on net pension obligation	(160,180)	(161,607)
Adjustment to annual required contribution	<u>177,855</u>	<u>179,439</u>
Annual pension cost	17,675	17,832
Interest on employer contributions	-0-	-0-
Contributions made	<u>-0-</u>	<u>-0-</u>
(Increase) decrease in net pension asset	17,675	17,832
Net pension (asset)/liability, beginning of year	<u>(2,002,252)</u>	<u>(2,020,084)</u>
Net pension (asset)/liability, end of year	<u>\$ (1,984,577)</u>	<u>\$ (2,002,252)</u>

The annual required contribution for the current year was determined as part of the May 1, 2013, actuarial valuation using the Unit Credit Cost Method. The actuarial assumptions included (a) 8.0 percent investment rate of return (net of administrative expenses) and (b) projected salary increases of 0.0 percent and (c) an inflation rate of 4.0 percent. The actuarial value of assets was determined using the market value of assets. The unfunded actuarial accrued liability is being amortized on a level dollar basis. The amortization period is 30 years from the valuation date.

<u>Three-Year Trend Information</u>			
<u>Fiscal Year</u> <u>Ending</u>	<u>Annual</u> <u>Pension Cost</u>	<u>Percentage of</u> <u>APC Contributed</u>	<u>Net Pension</u> <u>Asset</u>
12/31/2011	\$ 267,061	93.3%	\$ (2,020,084)
12/31/2012	17,832	0.0%	(2,002,252)
12/31/2013	17,675	0.0%	(1,984,577)

During 2010, the Medical Center froze the plan, no longer allowing new participants, and discontinuing the accrual of benefits for additional years of service for active participants.

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Required supplementary information relating to the defined benefit pension plan is as follows:

Plan Year Ending	12/31/13	12/31/12	12/31/11
Actuarial Valuation Date	5/1/2013	5/1/2012	5/1/2011
Actuarial Value of Plan Assets	\$ 31,113,055	\$ 28,606,679	\$ 30,098,727
Actuarial Accrued Liability	\$ 25,974,487	\$ 25,285,073	\$ 24,778,642
Total Unfunded Actuarial Liability	\$ -0-	\$ -0-	\$ -0-
Actuarial Value of Assets as a Percentage of the Actuarial Accrued Liability- "Funded Ratio"	119.8%	113.1%	121.5%
Annual Covered Payroll	N/A	N/A	N/A
Ratio of Unfunded Actuarial Liability to Annual Covered Payroll	N/A	N/A	N/A

11. LONG-TERM DEBT

At December 31, 2013 and 2012, the Medical Center was obligated for long-term debt agreements as follows:

	2013	2012
Indiana Financing Authority Series 2010 Revenue Bonds dated December 2010, payable in annual principal installments commencing February 2011 through February 2022, in amounts ranging from \$325,000 to \$1,765,000. Serial fixed interest rates ranging from 3.0% to 5.0%. Secured by gross revenues.	\$ 13,530,000	\$ 14,760,000
Indiana Health and Educational Facility Financing Authority ("IHEFFA") Series 2006A Revenue Bonds dated May 2006, payable in annual principal installments commencing February 2023 through February 2030, in amounts ranging from \$465,000 to \$670,000. Fixed interest rate of 5.125%. Secured by gross revenues.	4,500,000	15,000,000

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IHEFFA Series 2006B Revenue Bonds dated May 2006, payable in annual principal installments commencing February 2007 through February 2036 in amounts ranging from \$150,000 to \$950,000. In May 2013, bonds were converted to long-maturity and issued to Capital One Public Funding, LLC and Jackson County Bank who will hold the bonds through February 2023 at which time a balloon payment is due for all remaining unpaid principal and interest. In February 2023, Capital One and Jackson County Bank may exercise a put option on the bonds, or refinance the remaining principal with the Medical Center. Fixed interest rate of 2.8% on \$18,945,000. Secured by gross revenues.

	18,945,000	19,095,000
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Note payable to bank dated February 2010, due December 2014; monthly payments of \$8,483, including interest beginning February 2010; fixed interest rate of 4% per annum. Secured by equipment with a December 31, 2013 net book value of \$112,865.

	94,761	190,599
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JMB note payable to bank dated September 1995, assumed by Hospital in 2011, due July 2015; monthly payments of \$20,326, including interest; variable interest rate equal to 2.50% above the weekly average yield of the U.S. Treasury Securities adjusted to a constant maturity of years (4.75% at December 31, 2013). Secured by building with a December 31, 2013 net book value of \$3,461,313.

	<u>370,678</u>	<u>592,135</u>
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	37,440,439	49,637,734
--	------------	------------

Unamortized bond premium

	269,088	468,821
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Less current portion

	<u>(1,791,408)</u>	<u>(1,732,650)</u>
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Long-term debt, net of current portion

	<u>\$ 35,918,119</u>	<u>\$ 48,373,905</u>
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In May 2013, the Medical Center advanced refunded \$10,500,000 of the outstanding 2006A revenue bonds having interest rates of 5 percent and 5.25 percent. The Medical Center used cash reserves and excess debt service reserve funds to purchase U.S. government securities. These securities were deposited in an irrevocable trust to provide for all future debt service on the refunded portion of the 2006A bonds. As a result, that portion of the 2006A bonds is considered defeased, and the Medical Center has removed the liability from its accounts. The outstanding principal of the defeased

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bonds is \$15,000,000 at December 31, 2013. The advance refunding reduced total debt service payments over the next 17 years by approximately \$20,675,000. The advanced refunding resulted in a deferred loss on bond refunding of \$1,226,223.

Long-term debt activity for the years ended December 31, 2013 and 2012 was as follows:

	2013				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Revenue bonds, series 2006A	\$ 15,000,000	\$ -0-	\$ (10,500,000)	\$ 4,500,000	\$ -0-
Revenue bonds, series 2006B	19,095,000	-0-	(150,000)	18,945,000	150,000
Revenue bonds, series 2010	14,760,000	-0-	(1,230,000)	13,530,000	1,285,000
Note payable to bank	190,599	-0-	(95,838)	94,761	94,761
JMB note payable to bank	592,135	-0-	(221,457)	370,678	231,245
Bond premiums	468,821	-0-	(199,733)	269,088	30,402
Total long-term debt	<u>\$ 50,106,555</u>	<u>\$ -0-</u>	<u>\$ (12,397,028)</u>	<u>\$ 37,709,527</u>	<u>\$ 1,791,408</u>

	2012				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Revenue bonds, series 2006A	\$ 15,000,000	\$ -0-	\$ -0-	\$ 15,000,000	\$ -0-
Revenue bonds, series 2006B	19,245,000	-0-	(150,000)	19,095,000	150,000
Revenue bonds, series 2010	15,955,000	-0-	(1,195,000)	14,760,000	1,230,000
Note payable to bank	282,605	-0-	(92,006)	190,599	95,838
JMB note payable to bank	802,506	-0-	(210,371)	592,135	220,538
Bond premiums	505,095	-0-	(36,274)	468,821	36,274
Total long-term debt	<u>\$ 51,790,206</u>	<u>\$ -0-</u>	<u>\$ (1,683,651)</u>	<u>\$ 50,106,555</u>	<u>\$ 1,732,650</u>

Debt service requirements on long-term debt at December 31, 2013 are based on the interest rate modes in effect and are as follows:

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>
2014	\$ 1,791,408	\$ 1,362,990
2015	1,649,835	1,353,596
2016	1,565,402	1,293,910
2017	1,635,402	1,220,460
2018	1,705,402	1,143,511
2019 - 2023	25,306,800	4,046,844
2024 - 2028	2,745,553	709,507
2029 - 2033	1,309,725	68,863
Total	<u>\$ 37,709,527</u>	<u>\$ 11,199,681</u>

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The Medical Center's debt agreements contain various restrictive covenants, including covenants related to days cash on hand ratio, debt service coverage ratio, debt to capitalization ratio, and audited financial statement submission requirements. Management believes the Medical Center was in compliance with all restrictive covenants during 2013 and 2012.

12. DEFERRED COMPENSATION PLAN

The Medical Center offers its employees deferred compensation plans in accordance with Internal Revenue Code Sections 457 and 403(b). The plans, available to all Medical Center employees, permit them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plans, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the Medical Center (without being restricted to the provisions of benefits under the plans), subject only to the claims of the Medical Center's general creditors. Participants' rights under the plans are equal to those of general creditors of the Medical Center in an amount equal to the fair market value of the deferred account for each participant. The Medical Center believes that it is unlikely that it will use the assets to satisfy the claims of general creditors in the future. The deferred compensation assets and related liabilities under these plans are reported in the consolidated balance sheets as assets whose use is limited and deferred compensation liabilities, respectively. The amounts recognized as both deferred compensation assets and liabilities were \$7,534,110 and \$5,921,642 for the years ended December 31, 2013 and 2012, respectively.

In 2010, the Medical Center amended its 403(b) defined contribution plan to allow for employer discretionary and matching contributions. For the years ended December 31, 2013 and 2012, the Medical Center recognized \$1,126,803 and \$1,066,093, respectively, in expense related to the 403(b) plan.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

13. DONOR-RESTRICTED AND NONEXPENDABLE RESTRICTED NET POSITION

Donor-restricted net position amounts are donor-restricted for a specific use or by the passage of time. Nonexpendable restricted net position amounts include a perpetual trust. Donor-restricted and nonexpendable restricted net position amounts include the following at December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Donor-restricted net position		
Dr. Bud Fund	\$ 497,355	\$ 435,256
Medical Technology Fund	143,515	67,111
Women's Center Fund	1,775	1,275
Cancer Fund	453,734	394,851
Hospice Fund	225,576	196,360
EPIC Fund	155,559	125,930
Employee Humanitarian Fund	<u>6,792</u>	<u>6,939</u>
Total donor-restricted net position	<u>\$ 1,484,306</u>	<u>\$ 1,227,722</u>
Nonexpendable restricted net position		
Perpetual trust, held by trustee	<u>\$ 336,528</u>	<u>\$ 306,945</u>

Dr. Bud Fund

The Dr. Bud Fund was established to provide scholarships to area students seeking to pursue careers in healthcare. Scholarships are awarded based on the recommendations of the Dr. Bud Fund Scholarship Committee.

EPIC Fund

The EPIC (Employee Partners Invested in Caring) Fund was established to receive financial support from its members for special projects and programs recommended by those members.

Perpetual Trust, Held by Trustee

The perpetual trust, held by trustee represents a donation that is held in a separate trust account. The donation is to be held in perpetuity. The Hospital has no control over the investment strategy of the trust, and will not receive any payments from the trust's principal. However, the Hospital is entitled to receive 20 percent of the trust's net income each year. All of the Hospital's portion of income earned by this trust is unrestricted and may be used at the Hospital's Board of Trustee's discretion.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

14. NET PATIENT SERVICE REVENUE

For the years ended December 31, 2013 and 2012, net patient service revenue was as follows:

	<u>2013</u>	<u>2012</u>
Gross patient service revenue		
Inpatient routine services	\$ 12,073,925	\$ 12,486,068
Inpatient ancillary services	58,548,823	60,862,018
Outpatient services	207,602,452	202,773,128
Long-term care services	<u>85,542,021</u>	<u>7,113,021</u>
Total gross patient service revenue	363,767,221	283,234,235
Deductions from revenue		
Contractual allowances	173,205,276	135,789,475
Charity care	5,339,382	5,816,110
Bad debts	12,380,235	18,175,343
Medicaid UPL and DSH payments recognized	(4,951,751)	(708,153)
Nursing homes UPL payments recognized	<u>(14,408,284)</u>	<u>(971,614)</u>
Total deductions from revenue	171,564,858	158,101,161
 Total net patient service revenue	 <u>\$ 192,202,363</u>	 <u>\$ 125,133,074</u>

The Medical Center grants credit without collateral to its patients, most of whom are local residents and insured under third-party payor agreements. The mix of gross revenues and receivables from patients and third-party payors at December 31, 2013 and 2012, was as follows:

	<u>2013</u>		<u>2012</u>	
	<u>Revenues</u>	<u>Receivables</u>	<u>Revenues</u>	<u>Receivables</u>
Medicare	39 %	25 %	39 %	19 %
Medicaid	21	17	13	10
Blue Cross	17	10	21	13
SIHO*	7	5	9	5
Other third-party payors	8	15	11	14
Patients	<u>8</u>	<u>28</u>	<u>7</u>	<u>39</u>
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

*Southeastern Indiana Health Organization

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

The Medical Center has agreements with third-party payors that provide for payments at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

- **Medicare.** The Medical Center is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Medical Center is reimbursed for Medicare inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicare outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Hospital's year end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. The Hospital's classification of patients under the Medicare program and the appropriateness of their admissions are subject to an independent review by a peer review organization under contract with the Hospital. As of December 31, 2013, the Hospital's submitted Medicare cost reports have been final settled with the Fiscal Intermediary through December 31, 2009.
 - **Medicaid.** The Medical Center is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Medical Center is reimbursed for Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. There is no cost settlement for either of the inpatient or outpatient programs.
 - **Charity Care.** The Medical Center provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Because the Medical Center does not collect amounts deemed to be charity care, they are not reported as revenue. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Medical Center's total operating expenses divided by gross patient service revenue. For the years ended December 31, 2013 and 2012, the Hospital incurred estimated costs of \$2,121,060 and \$2,270,902, respectively.
 - **Other.** The Medical Center has also entered into preferred provider agreements with certain commercial insurance carriers. The basis for payment to the Medical Center under these agreements includes discounts from established charges, fee schedules, as well as inpatient DRG reimbursement methodologies.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. The Medical Center believes that it is in compliance with all applicable laws and regulations.

15. ELECTRONIC HEALTH RECORDS (EHR) INCENTIVE PAYMENTS

The Medical Center receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for EHR incentive payments, the Medical Center must meet "meaningful use" criteria that become more stringent over time. The Medical Center periodically submits and attests to its use of certified EHR technology, satisfaction of meaningful use objectives, and various patient data. These submissions generally include performance measures for each annual EHR reporting period (Federal fiscal year ending on September 30th). The related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in the Medical Center's cost reports. The payment calculation is based upon an initial amount as adjusted for discharges, program utilization using inpatient days multiplied by a factor of total charges excluding charity care to total charges, and a transitional factor that ranges from 100% in first payment year and thereby decreasing by 25% each payment year until it is completely phased out in the fifth year.

The Medical Center recognizes EHR incentive payments as grant income when there is reasonable assurance that the Medical Center will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the financial statement effects of the grants must be both recognizable and measurable. During 2013 and 2012, the Medical Center recognized approximately \$1,390,674 and \$1,846,587, respectively, in EHR incentive payments as grant income using the cliff recognition method. Under the cliff recognition method, the Medical Center records income at the end of EHR reporting period in which compliance is achieved. EHR incentive income is included in other revenue on the consolidated statements of operations and changes in net position. EHR incentive income is recognized based on management's estimate and amounts are subject to change, with such changes impacting operations in the period the changes occur.

Receipt of these funds is subject to the fulfillment of certain obligations by the Medical Center as prescribed by the program, subject to future audits and may be subject to repayment upon a determination of noncompliance.

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16. HOSPITAL ASSESSMENT FEE

During 2012, the Hospital Assessment Fee (HAF) Program for the period July 1, 2011 through June 30, 2013 was approved by Centers for Medicare & Medicaid Services ("CMS") retroactive to July 1, 2011. During March 2014, the HAF program was reinstated by CMS retroactive to July 1, 2013. As a result, the Medical Center estimated and recognized amounts for the period July 1, 2013 to December 31, 2013 in the 2013 financial statements. The purpose of the HAF Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share ("DSH") payments for Indiana hospitals as reflected in the hospital assessment fee reported in the consolidated statements of operations and changes in net position. Previously, the State share was funded by government entities through intergovernmental transfers. The Medicaid enhanced payments relate to both fee for service and managed care claims. The Medicaid enhanced payments are designed to follow the patient and result in increased Medicaid rates. The Medical Center recognized HAF program expense of \$4,731,229 and \$5,816,239 at December 31, 2013 and 2012, respectively. For the years ended December 31, 2013 and 2012, the Medical Center recognized revenue in net patient service revenue totaling \$4,951,751 and \$708,153, respectively, relating to the net Indiana Medicaid Municipal Hospital Upper Payment Limit ("UPL") and DSH adjustments.

17. NONOPERATING REVENUES (EXPENSES)

For the years ended December 31, 2013 and 2012, nonoperating revenues (expenses) were as follows:

	<u>2013</u>	<u>2012</u>
Investment income (loss)	\$ 7,938,500	\$ 4,765,709
Interest expense	(1,656,831)	(1,984,650)
Gain (loss) on disposal of capital assets	60,486	(96,134)
Donations	(149,987)	(56,917)
Contributions and grants	547,323	504,616
Change in perpetual trust	29,583	21,274
Miscellaneous	<u>(53,761)</u>	<u>(21,346)</u>
Total nonoperating revenues (expenses)	<u>\$ 6,715,313</u>	<u>\$ 3,132,552</u>

GASB requires interest expense to be reported as nonoperating expense while FASB requires interest expense to be reported as an operating expense.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

18. PROFESSIONAL LIABILITY INSURANCE

The Indiana Medical Malpractice Act, IC 34-18, provides a maximum recovery of \$250,000 for an occurrence of malpractice and \$1,250,000 for an injury or death of a patient due to an act of malpractice. The Act requires physicians to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$750,000 in the annual aggregate and hospitals to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$5,000,000 for hospitals with fewer than 100 occupied beds. The Act also requires the Medical Center to pay a surcharge to the State Patient's Compensation Fund. This fund may be used to pay medical malpractice claims in excess of the annual aggregate amount noted above, under certain terms and conditions.

The Medical Center maintains professional liability insurance through a multiprovider reciprocal risk retention group (the "Group"), in which premiums are accrued based on the Group's experience to date. This provides protection from liability in amounts not to exceed as follows:

	2013	2012
Medical Center per occurrence	<u>\$ 250,000</u>	<u>\$ 250,000</u>
Medical Center aggregate	<u>\$ 5,000,000</u>	<u>\$ 5,000,000</u>
Group umbrella aggregate	\$ 10,000,000	\$ 10,000,000
Group first additional umbrella aggregate	10,000,000	10,000,000
Group second additional umbrella aggregate	<u>10,000,000</u>	<u>10,000,000</u>
Total Group umbrella aggregate	<u>\$ 30,000,000</u>	<u>\$ 30,000,000</u>

Liabilities for incurred but not reported losses at December 31, 2013 and 2012 are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Medical Center's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the policies not be renewed or replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Medical Center intends to continue carrying such insurance.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

19. RELATED PARTY TRANSACTIONS

Jackson County Bank

The Medical Center's Executive Vice President and Chief Administrative and Operations Officer serves as a member of the Board of Directors for Jackson County Bank ("JCB"). At December 31, 2013 and 2012, and for the years then ended, the Medical Center had the following related party transactions with JCB:

	<u>2013</u>	<u>2012</u>
Deposits	\$ 32,756,327	\$ 36,539,653
Bonds payable	\$ 3,000,000	\$ -0-
Note payable	\$ 94,761	\$ 190,599
Interest income	\$ 123,103	\$ 120,375
Interest expense	\$ 51,692	\$ 9,791

20. CONCENTRATIONS OF CREDIT RISK

The Medical Center maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Medical Center has not experienced any losses on such accounts. The Medical Center believes it is not exposed to any significant credit risk on cash.

21. OPERATING LEASES

The Medical Center leases certain building space and equipment under noncancelable operating leases expiring in various years through 2017. Minimum future rental payments under these noncancelable operating leases, as of December 31, 2013, are as follows:

Year Ending December 31,	<u>Amount</u>
2014	\$ 78,609
2015	33,000
2016	36,000
2017	<u>36,000</u>
Total minimum payments	<u>\$ 183,609</u>

The Medical Center incurred \$8,678,436 and \$1,074,339 in total rent expense for the years ended December 31, 2013 and 2012, respectively, under cancelable and noncancelable operating leases.

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22. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Medical Center in estimating the fair value of its financial instruments:

Cash and Cash Equivalents

The carrying amount reported in the consolidated balance sheets for cash and cash equivalents approximates its fair value based on the short maturities of those items.

Investments

The carrying amount reported in the consolidated balance sheets for investments approximates its fair value based on the short maturities of those items.

Assets Whose Use is Limited

These assets are reported in the consolidated balance sheets at fair value. The fair value amounts are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

Accounts Payable, Accrued Payroll and Payroll Withholdings, and Accrued Expenses

The carrying amounts reported in the consolidated balance sheets for accounts payable, accrued payroll and payroll withholdings, and accrued expenses approximate their fair value based on the short maturities of those items.

Estimated Third-Party Payor Settlements

The carrying amount reported in the consolidated balance sheets for estimated third-party payor settlements approximates its fair value because they are expected to be settled in the near future.

Long-Term Debt

The carrying amounts reported in the consolidated balance sheets for long-term debt at December 31, 2013 and 2012 is \$37,709,527 and \$50,106,555, respectively. The fair value of long-term debt at December 31, 2013 and 2012 is approximately \$37,392,383 and \$55,473,056, respectively.

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Deferred Compensation Liabilities and Deferred Costs

The carrying amounts reported in the consolidated balance sheets for deferred compensation liabilities and deferred costs approximate their fair value. The fair value amounts are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

23. CONTINGENCIES

There are a variety of legal proceedings and claims by others against the Medical Center in a variety of matters arising out of the conduct of the Medical Center's business. The ultimate resolution of such claims would not, in the opinion of management, have a material adverse effect on the consolidated financial statements.

24. COMMITMENTS

As of December 31, 2013, the Medical Center has construction and renovation project commitments as follows:

Project	Expected Date of Completion	Estimated Total Cost of Project	Costs Incurred as of December 31, 2013
Telephone system upgrade	2014	\$ 750,000	\$ 308,658
Cummins generator installation	2014	1,200,000	1,036,862
Operating room remodel	2015	1,500,000	136,897
Brownstown building remodel	2014	673,000	42,747
All other projects	2014	2,407,000	740,401
		<u>\$ 6,530,000</u>	<u>\$ 2,265,565</u>

25. CONDENSED FINANCIAL INFORMATION

The Medical Center includes four blended component units in its reporting entity. Condensed component unit information for all of its blended as of and for the year ended December 31, 2013 is as follows:

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

	HDC	Foundation	JMB	Total
Balance sheet				
Assets				
Current assets	\$ 1,990,186	\$ 564,227	\$ 577,384	\$ 3,131,797
Assets whose use is limited	-0-	1,484,306	-0-	1,484,306
Capital assets, net	737,590	722,335	3,461,313	4,921,238
Other assets	345,739	-0-	-0-	345,739
Total assets	3,073,515	2,770,868	4,038,697	9,883,080
Deferred outflows	-0-	-0-	-0-	-0-
Total assets and deferred outflows	\$ 3,073,515	\$ 2,770,868	\$ 4,038,697	\$ 9,883,080
Liabilities				
Current liabilities	\$ 715,177	\$ 45,447	\$ 257,977	\$ 1,018,601
Long-term liabilities	215,833	-0-	139,433	355,266
Total liabilities	931,010	45,447	397,410	1,373,867
Net position				
Net investment in capital assets	694,843	-0-	-0-	694,843
Restricted expendable	-0-	1,484,306	-0-	1,484,306
Restricted nonexpendable	-0-	-0-	-0-	-0-
Unrestricted	1,447,662	1,241,115	3,641,287	6,330,064
Total net position	2,142,505	2,725,421	3,641,287	8,509,213
Total liabilities and net position	\$ 3,073,515	\$ 2,770,868	\$ 4,038,697	\$ 9,883,080
	HDC	Foundation	JMB	Total
Statement of operations and changes in net position				
Operating revenues				
Net patient service revenue	\$ 2,231,411	\$ -0-	\$ -0-	\$ 2,231,411
Other operating revenue	1,587,715	-0-	787,975	2,375,690
Total operating revenues	3,819,126	-0-	787,975	4,607,101
Operating expenses				
Depreciation and amortization	171,916	3,079	164,856	339,851
Other operating expenses	4,526,089	54,700	384,558	4,965,347
Total operating expenses	4,698,005	57,779	549,414	5,305,198
Income (loss) from operations	(878,879)	(57,779)	238,561	(698,097)
Non-operating gains (losses)	21,415	837,396	(22,441)	836,370
Change in net position	(857,464)	779,617	216,120	138,273
Net position - beginning of year	2,999,969	1,945,804	3,425,167	8,370,940
Net position - end of year	\$ 2,142,505	\$ 2,725,421	\$ 3,641,287	\$ 8,509,213
Statement of cash flows				
Cash provided by				
Operating activities	\$ (41,746)	\$ 211,280	\$ 376,392	\$ 545,926
Noncapital financing activities	-0-	759,845	-0-	759,845
Capital and related financing activities	(46,009)	(326,381)	(221,457)	(593,847)
Investing activities	131,821	(786,391)	-0-	(654,570)
Total	44,066	(141,647)	154,935	57,354
Cash - beginning of year	1,036,951	302,099	400,737	1,739,787
Cash - end of year	\$ 1,081,017	\$ 160,452	\$ 555,672	\$ 1,797,141

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Condensed component unit information for all of its blended components as of and for the year ended December 31, 2012 is as follows:

	HDC	Foundation	JMB	Total
Balance sheet				
Assets				
Current assets	\$ 2,142,067	\$ 731,987	\$ 417,865	\$ 3,291,919
Assets whose use is limited	-0-	1,227,722	-0-	1,227,722
Capital assets, net	849,629	-0-	3,626,169	4,475,798
Other assets	748,820	-0-	-0-	748,820
Total assets	3,740,516	1,959,709	4,044,034	9,744,259
Deferred outflows	-0-	-0-	-0-	-0-
Total assets and deferred outflows	\$ 3,740,516	\$ 1,959,709	\$ 4,044,034	\$ 9,744,259
Liabilities				
Current liabilities	\$ 635,547	\$ 13,905	\$ 247,270	\$ 896,722
Long-term liabilities	105,000	-0-	371,597	476,597
Total liabilities	740,547	13,905	618,867	1,373,319
Net position				
Net investment in capital assets	849,629	-0-	-0-	849,629
Restricted expendable	-0-	1,227,722	-0-	1,227,722
Restricted nonexpendable	-0-	-0-	-0-	-0-
Unrestricted	2,150,340	718,082	3,425,167	6,293,589
Total net position	2,999,969	1,945,804	3,425,167	8,370,940
Total liabilities and net position	\$ 3,740,516	\$ 1,959,709	\$ 4,044,034	\$ 9,744,259
	HDC	Foundation	JMB	Total
Statement of operations and changes in net position				
Operating revenues				
Net patient service revenue	\$ 2,196,816	\$ -0-	\$ -0-	\$ 2,196,816
Other operating revenue	1,287,564	4,635	789,190	2,081,389
Total operating revenues	3,484,380	4,635	789,190	4,278,205
Operating expenses				
Depreciation and amortization	177,922	-0-	159,012	336,934
Other operating expenses	3,977,012	51,727	401,831	4,430,570
Total operating expenses	4,154,934	51,727	560,843	4,767,504
Income (loss) from operations	(670,554)	(47,092)	228,347	(489,299)
Non-operating gains (losses)	(104,177)	117,180	(33,512)	(20,509)
Change in net position	(774,731)	70,088	194,835	(509,808)
Net position - beginning of year	3,774,700	1,875,716	3,230,332	8,880,748
Net position - end of year	\$ 2,999,969	\$ 1,945,804	\$ 3,425,167	\$ 8,370,940

JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Statement of cash flows

Cash provided by				
Operating activities	\$ (142,968)	\$ 180,711	\$ 369,456	\$ 407,199
Noncapital financing activities	-0-	352,052	-0-	352,052
Capital and related financing activities	(50,203)	-0-	(359,120)	(409,323)
Investing activities	(329,561)	(802,032)	-0-	(1,131,593)
Total	(522,732)	(269,269)	10,336	(781,665)
Cash - beginning of year	1,559,683	571,368	390,401	2,521,452
Cash - end of year	<u>\$ 1,036,951</u>	<u>\$ 302,099</u>	<u>\$ 400,737</u>	<u>\$ 1,739,787</u>

26. RECENT GASB PRONOUNCEMENTS

Management has not currently determined what effects, if any, the implementation of the following recently enacted statements may have on its future financial statements:

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No. 27*, issued June 2012, will be effective for periods beginning after June 15, 2014. This Statement establishes the accounting and financial reporting standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures related to certain pensions. It will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire net pension liability and a more comprehensive measure of pension expense.

GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, issued January 2013, will be effective for government combinations and disposals of government operations occurring in financial reporting periods for periods beginning after December 15, 2013. This Statement establishes accounting and financial reporting standards related to government combinations (mergers, acquisitions, and transfers of operations) and disposals of government operations. The disclosures required by this Statement will enable financial statement users to evaluate the nature and financial effects of those transactions.

GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, issued April 2013, will be effective for financial reporting periods beginning after June 15, 2013. This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. Additional disclosures will be required by both governments that extend and receive financial guarantees.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date-an Amendment of GASB Statement No. 68*, issued November 2013, will be required to be applied simultaneously with provisions of GASB Statement No. 68 making it effective for periods beginning after June 15, 2014. This Statement amends previous guidance to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability.